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In the Supreme Court of the United States

OCTOBER TERM, 1988

UNITED STATES OF AMERICA, PETITIONER

v.

FRANCES L. DALM

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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QUESTION PRESENTED

Whether the doctrine of equitable recoupment permits a taxpayer to maintain a suit against the United States for the recovery of an erroneous tax payment, when that suit is barred as untimely by Sections 7422 and 6511 of the Internal Revenue Code.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

The Solicitor General, on behalf of the United States of America, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Sixth Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-16a) is reported at 867 F.2d 305. The opinion of the district court (App., *infra*, 17a-20a) is not reported.

JURISDICTION

The judgment of the court of appeals (App., *infra*, 21a-22a) was entered on February 8, 1989. On May 2, 1989, Justice Scalia extended the time to petition for a writ of certiorari to and including June 8, 1989. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTORY PROVISIONS INVOLVED

Sections 6511 and 7422 of the Internal Revenue Code (26 U.S.C.) are set forth in pertinent part in a statutory appendix (App., *infra,* 23a-24a):

STATEMENT

1. Respondent was appointed administratrix of the estate of Harold Schrier in May 1975. The appointment was made at the request of Clarence Schrier, the decedent's brother and sole beneficiary of the estate. The estate paid respondent fees of $30,000 in 1976 and $7,000 in 1977, which were approved by the probate court. Respondent also received from Clarence Schrier a payment of $180,000 in 1976 and a payment of $133,813 in 1977. In December 1976, Clarence Schrier and his wife filed a gift tax return reporting the $180,000 transfer in that year as a gift to respondent, and respondent paid the reported gift tax of $18,675. The Schriers subsequently were assessed $1,587 in interest and penalties with respect to the 1976 transfer, which they paid and for which respondent reimbursed them. No gift tax return was filed respecting the 1977 payment. App., *infra,* 2a, 17a.

On audit, the Internal Revenue Service (IRS) determined that the payments made by Clarence Schrier to respondent represented additional fees for her services as administratrix of the estate. The IRS accordingly asserted deficiencies in respondent's income tax for the years 1976 and 1977. Respondent petitioned the Tax Court for a redetermination of the asserted deficiencies, contending that the transfers of $180,000 and $133,813 were gifts from Clarence Schrier intended to carry out his brother's intention that respondent share in his estate. In September 1984, after two days of trial, the parties negotiated a settlement of the Tax Court case for one-half the amount of the

asserted deficiencies (excluding penalties), applying $70,639 to pay the 1977 deficiency in full and applying the remaining $10,416 to the deficiency for 1976. App., *infra,* 2a-3a, 17a-18a.

2. In November 1984, respondent filed an administrative claim for refund of the $20,262 in gift tax, interest, and penalties paid with respect to the $180,000 transferred to her in 1976. App., *infra,* 3a. This claim was untimely since it was filed almost five years after the expiration of the three-year limitations period specified in Section 6511 of the Internal Revenue Code.[1] After the IRS failed to act upon the claim within six months, respondent brought this refund suit in the United States District Court for the Western District of Michigan.

The district court granted the government's motion to dismiss for lack of jurisdiction (App., *infra,* 17a-20a). The court rejected respondent's contention that the suit could be maintained under the doctrine of equitable recoupment set forth in *Bull* v. *United States,* 295 U.S. 247 (1935), even though the suit unquestionably was untimely under the applicable statute of limitations. Citing this Court's decision in *Rothensies* v. *Electric Storage Battery Co.,* 329 U.S. 296 (1946), the court concluded that there is no authority for applying equitable recoupment in "an independent lawsuit, such as this suit, * * * maintained for a refund for a year in which the statute of limitations has expired" (App., *infra,* 19a).[2]

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[1] Unless otherwise noted, all statutory references are to the Internal Revenue Code of 1954 (26 U.S.C.), as amended (the Code or I.R.C.).

[2] The district court also observed that the Tax Court settlement appeared designed to reflect the prior payment of gift tax, and therefore that respondent in any event would not be entitled to a refund of that tax (App., *infra,* 20a). The court also stated that, pursuant to Section 6512(a) of the Code, institution of the Tax Court proceeding for 1976 barred this suit for refund of 1976 taxes (*ibid.*).

The court of appeals reversed (App., *infra,* 1a-16a). The court held that the doctrine of equitable recoupment allowed the taxpayer to bring the untimely suit because the payment of the gift tax was inconsistent with the treatment in the Tax Court settlement of the transfers as fees for services rendered. The court of appeals characterized this Court's decision in *Rothensies* v. *Electric Storage Battery Co., supra,* from which the district court had quoted, as narrowing the application of the equitable recoupment doctrine established in *Bull* v. *United States, supra* (see App., *infra,* 6a), but stated that "[t]he facts in *Rothensies* were quite different from those in *Bull* and the present case" (*id.* at 8a).

Citing the Ninth Circuit's decision in *Kolom* v. *United States,* 791 F.2d 762 (1986), the court then stated that there are three prerequisites for the application of equitable recoupment (App., *infra,* 9a-10a): "There must be (1) a single transaction or taxable event, (2) that event must be subjected to two taxes based on inconsistent legal theories, and (3) the amount claimed in recoupment must be barred by limitations while the government's deficiency claim must be timely." The court held that these three criteria were satisfied. With respect to the third criterion, the court stated (*id.* at 10a-11a): "[Respondent's] refund action was not barred by the statute of limitations though filed more than three years after the gift taxes were paid. Her claim for recoupment related to the government's timely deficiency action and was timely as well for purposes of recoupment."[3]

[3] The court of appeals also held that the district court could not grant summary judgment for the government on the alternative ground that the 1976 Tax Court settlement reflected the gift tax overpayment (App., *infra,* 14a-16a). The court of appeals remanded for factfinding on the intent of the parties to the Tax Court settlement (*id.* at 16a).

REASONS FOR GRANTING THE PETITION

The decision below marks a serious departure both from the jurisdictional framework established by Congress to govern tax litigation and from legal principles clearly established by this Court. There is no doubt that the instant suit is untimely under the statute of limitations that governs tax refund suits. And the doctrine of equitable recoupment does not eliminate that statutory bar to suit. A consistent line of cases of this Court, dating from *Bull* v. *United States,* 295 U.S. 247 (1935), as well as numerous court of appeals cases, makes clear that a claim of equitable recoupment must be raised in a timely suit. While the doctrine permits a taxpayer (or the government) to raise *as an offset or credit* a claim that would be time-barred if advanced as the ground for an independent lawsuit, it plainly does not allow a party to commence an action that is barred by the statute of limitations.

If permitted to stand, the decision below would have deleterious consequences for the administration of the tax laws. It would relieve some taxpayers of the need to comply with the conditions prescribed by Congress for obtaining a refund, while taxpayers in other circuits would remain governed by the statute of limitations contained in the Code. And the approach of the court below would upset the goals of finality and repose that Congress sought to advance in establishing a definite statute of limitations for refund suits. Moreover, the uncertainty engendered by the decision below creates difficulties for taxpayers in having to decide whether to pursue their claims in the Tax Court or in district court without knowing how that choice will affect their entitlement to recoupment. It is therefore important for this Court to grant certiorari to correct the court of appeals' misinterpretation of this Court's precedents concerning equitable recoupment and to resolve the resulting conflict in court of appeals decisions.

1. a. Petitioner's refund suit is unquestionably barred by the statute of limitations. Section 7422(a) of the Code provides that no refund suit "shall be maintained in any court * * * until a claim for refund or credit has been duly filed with the Secretary, according to the provisions of law in that regard." Section 6511(a) of the Code provides that, in the case of a tax (such as the gift tax) with respect to which a return is required, such a claim for refund must be filed "within 3 years from the time the return was filed or 2 years from the time the tax was paid." Section 6511(b)(1) provides that no credit or refund shall be allowed or made unless a timely claim has been filed. Respondent did not file a claim for refund until 1984, long after the expiration of the three-year period prescribed by Section 6511. Accordingly, under the statutory framework erected by Congress, the district court lacked jurisdiction to entertain respondent's refund suit. See, *e.g.*, *United States* v. *Mottaz*, 476 U.S. 834, 841 (1986); *United States* v. *Garbutt Oil Co.*, 302 U.S. 528, 533-535 (1938).

b. The doctrine of equitable recoupment provides no basis for district court jurisdiction where suit is barred by the statute of limitations. The applicability of that doctrine to tax cases has its source in this Court's decision in *Bull* v. *United States, supra.* In that case, the decedent had provided that his estate would continue to receive a share of the earnings from a partnership for a specified period following his death. On audit of the estate tax return, the Commissioner determined that those post-death partnership earnings were part of the value of the partnership interest includible in the gross estate. Subsequently, after additional estate tax had been paid to reflect this increase in the value of the gross estate, the Commissioner determined that the same post-death partnership earnings were also includible in the estate's gross income for income tax purposes. The estate paid the income tax deficiency as-

serted, but thereafter filed a timely refund claim and brought suit for the recovery of that income tax payment. The Court of Claims denied the claim for refund of income tax, finding that the partnership earnings were correctly treated as income of the estate. The court also rejected the estate's alternative contention that, if these earnings were income, it should receive a refund of the estate tax that was paid, finding that it could not consider this claim because the time for filing a refund claim for the estate tax had expired. See 295 U.S. at 254; 6 F. Supp. 141 (Ct. Cl. 1934). This Court reversed. The Court held that, even though the time for filing an independent claim for refund of the estate tax had expired, the doctrine of equitable recoupment permitted the executors to credit the overpayment of estate tax against the correctly-assessed income tax liability that was directly at issue in that refund suit.

Although the Court permitted the estate in *Bull* to reduce its total tax liability by crediting an estate tax payment that could no longer be the subject of a refund suit, the Court made clear that the doctrine of equitable recoupment does not override the jurisdictional bar imposed by a statute of limitations. Rather, the doctrine permits a time-barred claim to be raised only in a defensive way—by seeking an offset or credit against a tax that is the subject of a timely-filed action over which the court properly has jurisdiction. The Court explicitly stated that the inconsistent treatment that the estate suffered in *Bull* "cannot avail to toll the statute of limitations" (295 U.S. at 259). It noted therefore that, even though "[r]etention of the [estate tax overpayment] was against morality and conscience" (*id.* at 260), once the taxpayer had failed to seek a refund of estate tax within the limitations period, "[i]f nothing further had occurred Congressional action would have been the sole avenue of redress" (*id.* at 261). The

estate's ability to recoup the overpayment of estate tax arose only because that claim could be raised defensively in a timely-filed proceeding to determine the estate's income tax liability arising out of the same transaction. The Court summarized the operation of the doctrine of equitable recoupment as follows (*id.* at 262 (emphasis added)):

> If the claim for income tax deficiency had been the subject of a suit, any counter demand for recoupment of the overpayment of estate tax could have been asserted by way of defense and credit obtained notwithstanding the statute of limitations had barred an independent suit against the Government therefor. This is because recoupment is in the nature of a defense arising out of some feature of the transaction upon which the plaintiff's action is grounded. Such a defense is never barred by the statute of limitations *so long as the main action itself is timely.*

In sum, although the facts in *Bull* are similar to those of the instant case in many respects, they differ in one critical respect—*viz.*, that, in contrast to this case, the suit in *Bull* was instituted to recover a tax payment for which a *timely* refund claim had been filed, and the court therefore had jurisdiction over the action.

In subsequent cases, this Court has adhered to the clearly stated position that the doctrine of equitable recoupment can be invoked only to assert a credit against another tax—one that is the subject of either a timely refund claim and refund suit or a pending collection suit brought by the government. In *Stone* v. *White,* 301 U.S. 532 (1937), the Court held that the government also is entitled to invoke the doctrine of equitable recoupment in a timely refund suit by raising an offsetting claim that would be time-barred if raised in an independent suit. The Court explained (*id.* at 538-539): "The statutory bar to the right of

action for the collection of the tax does not prevent reliance upon a defense which is not a set-off or a counterclaim, but is an equitable reason, growing out of the circumstances of the erroneous payment, why petitioners ought not to recover."

Subsequently, in *Rothensies* v. *Electric Storage Battery Co.,* 329 U.S. 296, 302 (1946), the Court rejected an attempt to invoke equitable recoupment, on the ground that the allegedly inconsistent claims did not arise out of the same transaction. The Court stressed the importance of statutes of limitations, even though in some cases their application may yield what appears to be an inequitable result (*id.* at 301-303), and it expressed its concern that a broad expansion of the doctrine of equitable recoupment beyond the facts of *Bull* "would seriously undermine the statute of limitations in tax matters" (329 U.S. at 302). The Court concluded (*id.* at 303): "If there are to be exceptions to the statute of limitations, it is for Congress rather than for the courts to create and limit them." Thus, the decisions of this Court make clear that equitable recoupment may be invoked only to seek a credit against a related tax claim being litigated in a timely action; it does not provide a basis for ignoring the statute of limitations and bringing a time-barred action, as respondent did in this case.[4]

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[4] See generally Andrews, *Modern-Day Equitable Recoupment and the "Two Tax Effect:" Avoidance of the Statutes of Limitation in Federal Tax Controversies,* 28 Ariz. L. Rev. 595, 598-613 (1986); *id.* at 625 ("Under the doctrine of equitable recoupment, the barred claim is only usable to reduce or wipe out the open claim, but no more."); Willis, *Some Limits of Equitable Recoupment, Tax Mitigation, and Res Judicata: Reflections Prompted By* Chertkof *v.* United States, 38 Tax Law. 625, 633-640 (1985); *id.* at 633 ("Recoupment, rather than extending the statute of limitations to correct a perceived injustice, permits a wronged party to recoup the loss against a sum still open to litigation."); *id.* at 635 ("a recoupment claim must not be an independent counterclaim, but must instead be a defense to the main action").

c. As the Court pointed out in *Rothensies,* Congress has the power to create exceptions to the statute of limitations in order to ameliorate inequities caused by inconsistent tax treatment of the same transaction. In the wake of *Bull,* Congress took action in this regard, adopting the "mitigation provisions" now set forth at Sections 1311-1314 of the Code. See Section 820 of the Revenue Act of 1938, ch. 289, 52 Stat. 581. These complex provisions delineate various circumstances under which, in cases of inconsistent treatment, a tax year closed by the statute of limitations will be reopened for the correction of an error. See generally Willis, *Some Limits of Equitable Recoupment, Tax Mitigation, and Res Judicata: Reflections Prompted By* Chertkof *v.* United States, 38 Tax Law. 625, 633-640 (1985); Maguire, Surrey, and Traynor, *Section 820 of the Revenue Act of 1938,* 48 Yale L.J. 509 & 719 (1939). But the application of the mitigation provisions is limited by their terms (see especially § 1312), and the provisions plainly do not provide a blanket exemption from the otherwise applicable statute of limitations in all cases in which a double tax liability has been imposed with respect to a single transaction.

Thus, in situations not covered by the mitigation provisions (such as this case), the doctrine of equitable recoupment may still be invoked, but it may be used only to obtain a credit against another tax being litigated in a timely action. If the court below were correct in holding that equitable recoupment permits a taxpayer to bring an independent time-barred action, then the mitigation provisions, which permit such an independent action only in limited circumstances, would be superfluous, and the restrictions imposed by Congress upon the mitigation remedy would be meaningless.[5] Hence, the very existence

[5] Indeed, the Ninth Circuit in *Kolom* v. *United States,* 791 F.2d 762 (1986), the case upon which the court below relied (see page 13, *infra*),

of the mitigation provisions demonstrates that the court below has misapplied the doctrine of equitable recoupment.

2. a. The courts of appeals generally have recognized that, under *Bull,* equitable recoupment does not authorize a taxpayer to maintain an independent suit that is barred by the statute of limitations. On three separate occasions, the Court of Claims has rejected a taxpayer's attempt to invoke that doctrine as a basis for allowing a time-barred suit for refund. See *Ellard* v. *United States,* 228 Ct. Cl. 815 (1981); *Brigham* v. *United States,* 470 F.2d 571, 577 (Ct. Cl. 1972), cert. denied, 414 U.S. 831 (1973); *Evans Trust* v. *United States,* 462 F.2d 521, 525-526 (Ct. Cl. 1972). The court explained in *Evans Trust* that accepting the taxpayer's contention would have gone well beyond the doctrine established in *Bull* because the taxpayer was "attempting to use recoupment not in its traditional form as a defense to an asserted deficiency, but as an independent ground for reopening years now closed by the statute of limitations" (462 F.2d at 526).

The Seventh Circuit recently rejected the same contention in *O'Brien* v. *United States,* 766 F.2d 1038, 1048-1051 (1985). In that case, the IRS had placed a higher value on shares of stock for estate tax purposes than that reported on the return; applying that value as the basis for the taxpayer's computation of gain realized from the subsequent disposition of those shares would have entitled him to an income tax refund, but the time for filing such a refund

essentially acknowledged that the mitigation provisions become superfluous if equitable recoupment is expanded to permit a taxpayer to maintain an independent action that is barred by the statute of limitations. The court there stated (791 F.2d at 766 n.10): "The doctrine of equitable recoupment essentially requires the same criteria necessary to prove application of the mitigation provisions, the mitigation provisions requiring proof of even further criteria."

claim had expired.[6] Like respondent here, the taxpayer in *O'Brien* filed an untimely refund claim and brought suit to recover the income tax overpayment; he argued in the alternative that the claim should be allowed either under the mitigation provisions or under the doctrine of equitable recoupment. The Seventh Circuit rejected both theories.

The court stated that "it is clear that the doctrine [of equitable recoupment] does not lift the limitations bar to taxpayer's refund suit" (766 F.2d at 1048) because, in contrast to *Bull,* the taxpayer was seeking to invoke the doctrine to maintain an independent, time-barred action, not as a defense in an action that was timely filed. The court explained that "the doctrine requires some validly asserted deficiency or refund against which the asserting party desires to recoup a time-barred refund or deficiency * * * and requires the timeliness of the underlying action against which a party seeks to employ recoupment" (766 F.2d at 1049). The court then summarized its holding as follows (*ibid.*; footnote omitted):

> Attempts by taxpayers to utilize the doctrine to revive an untimely affirmative refund claim, as opposed to offset a timely government claim of deficiency with

[6] The taxpayer had received shares of stock from his father that were later included in the father's gross estate as gifts in contemplation of death (see I.R.C. § 2035). The estate valued the stock at $215 per share for this purpose, and the taxpayer used that same value as his basis in the stock for purposes of computing gain on the subsequent liquidation of the corporation. The IRS asserted an estate tax deficiency, claiming a higher value for the shares in question. The ensuing Tax Court litigation brought by the estate resulted in valuation of the stock at $280 per share. If the same value were applied to the shares for purposes of computing the gain realized on the liquidation, the taxpayer would have been entitled to a refund of part of the income tax he had paid on the reported gain. But the taxpayer failed to file a timely income tax refund claim to protect his position pending the outcome of the estate tax dispute.

> a barred claim of the taxpayer, have been uniformly rejected. * * * Plaintiff has invoked the doctrine in this precise manner and therefore the district court's holding that equitable recoupment permits the taxpayer's time-barred refund claim must be reversed. O'Brien's untimely refund suit in 1983 asserts recoupment affirmatively to recover an erroneously paid tax and does not seek to offset the amount of a properly asserted and timely deficiency.

b. The consistent adherence of the courts of appeals to *Bull* and its prohibition against the use of equitable recoupment to nullify the statute of limitations' bar to an independent action was disturbed in 1986 by the Ninth Circuit's decision in *Kolom* v. *United States,* 791 F.2d 762. In that case, the IRS disputed the year for which the taxpayer had reported and paid certain minimum tax liability, arguing that it should have been reported in 1972, not 1973. After litigation in the Tax Court, its determination of a deficiency for 1972 was upheld. The taxpayer, who had allowed the time for filing a refund claim for 1973 to expire, sought to file an untimely claim in reliance on the mitigation provisions. The Ninth Circuit held that the mitigation provisions were inapplicable but it then proceeded to rule on its own motion (see *id.* at 766 n.10) that the taxpayer's refund suit could be maintained under the doctrine of equitable recoupment. Ruling without the benefit of briefing on the equitable recoupment issue, the court reasoned that the doctrine may be invoked to nullify the statute of limitations whenever the government has been "unjustly enriched" by inconsistent treatment of a single transaction (*id.* at 766-767), and it accordingly applied the doctrine to allow the taxpayer's independent time-barred suit.[7]

[7] The holding in *Kolom* was criticized in the one law review article on equitable recoupment published subsequent to the decision. See

The court of appeals below has now followed the Ninth Circuit's approach in *Kolom* and discarded the established principle that equitable recoupment may be invoked only as a defense or credit in a timely-filed action. Respondent could have planned her litigation so as to enable her to claim a credit for the gift tax overpayment under a theory of equitable recoupment in a timely-filed income tax refund suit (see pages 17-18, *infra*), but she did not pursue that option and the court of appeals has erred in holding that the doctrine can nullify the jurisdictional bar against an independent suit that is established by a statute of limitations. Not only does the court's ruling conflict with this Court's decisions in *Bull* and its progeny, it presents a direct conflict in the circuits with *O'Brien* and with the Court of Claims cases, which are binding precedent in the Federal Circuit. The court of appeals' attempts to reconcile the contrary decisions are completely unpersuasive. With respect to the Court of Claims cases, the court of appeals stated that "at least one element required for the application of recoupment was missing" (App., *infra,* 14a), without acknowledging that the defect identified by the Court of Claims in each of the cases was the attempt to invoke equitable recoupment, not as a defense, but as an independent basis for jurisdiction over a time-barred refund suit (see page 11, *supra*).

Andrews, *supra,* 28 Ariz. L. Rev. at 626 n. 193:

> The Ninth Circuit is simply incorrect in this regard because if equitable recoupment is a permissible basis for a refund suit for the barred year rather than the open year, then it completely undercuts the statute of limitation. That this is true is evident from the fact that, in such case, it no longer operates merely to diminish the opposing party's right to recover, but, instead, is serving as an independent ground for obtaining a refund that is directly barred by a statute of limitation.

Similarly, the Seventh Circuit's decision in *O'Brien* cannot be reconciled with the decision in this case. The court below sought to distinguish *O'Brien* on the ground that the refund suit was not addressed to a tax for which a timely deficiency had been asserted; rather, the taxpayer had voluntarily paid the tax in question when he filed his return (see App., *infra,* 11a-13a). But this factual distinction is immaterial. First, the decision in *O'Brien* nowhere suggests that the absence of a deficiency notice played any role in the court's decision; to the contrary, the opinion focuses entirely on the taxpayer's misguided attempt to invoke equitable recoupment to maintain an independent time-barred suit. Second, it is not apparent why the issuance of a timely deficiency notice should be a prerequisite to an equitable recoupment claim; indeed, this proposition cannot be squared with this Court's decision in *Stone* v. *White, supra,* where the government was permitted to claim equitable recoupment in the taxpayer's timely refund action although the government's independent claim to a deficiency was time-barred. Third, the Seventh Circuit's opinion itself demonstrates that it would not agree with the basis for decision proffered by the court below. According to the court below, the absence of a timely deficiency notice absolutely barred the taxpayer in *O'Brien* from raising an equitable recoupment claim in any manner; the Seventh Circuit, however, noted that he could have raised such a claim in a timely estate tax refund action (766 F.2d at 1050).[8] Rather, the Seventh Circuit's

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[8] The court below also mistakenly read one footnote in *O'Brien* as supporting the use of equitable recoupment to maintain an independent time-barred claim (App., *infra,* 12a-13a). That footnote in *O'Brien* merely notes the settled proposition that a taxpayer can raise equitable recoupment as an offset not only in a collection suit by the United States, but also in a refund suit that the taxpayer has commenced to challenge an asserted tax liability that he has paid, so long

holding in *O'Brien* rests squarely and entirely on the ground "that the doctrine [of equitable recoupment] cannot be used 'as an independent ground for reopening years now closed by the statute of limitations' [citing *Evans Trust* v. *United States*, 462 F.2d at 526], and requires the timeliness of the underlying action against which a party seeks to employ recoupment" (766 F.2d at 1049).[9] In sum, the decision below clearly conflicts with the governing precedent in the Seventh and Federal Circuits.

3. The decision below, if permitted to stand, will disrupt the sound administration of the tax laws. The decision would have the effect of "completely undercutting" the statute of limitations in a discrete class of cases (see Andrews, *Modern-Day Equitable Recoupment and the "Two Tax Effect:" Avoidance of the Statutes of Limitation in Federal Tax Controversies*, 28 Ariz. L. Rev. 595, 625, 626 n.193 (1986)), thereby permitting the courts to entertain lawsuits in defiance of the limitations on jurisdiction and on suits against the United States that have been specifically established by Congress. The decision below would thus undermine the goals of finality and repose that Congress sought to advance by establishing a statute of limitations for taxpayer refund suits. As this

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as the refund suit is timely. See 766 F.2d at 1049 n.13. *Bull* itself involved the invocation of equitable recoupment in a refund suit brought by the taxpayer.

[9] The court in *Kolom* devised a different—and equally misguided—theory for distinguishing *O'Brien*, arguing that the Seventh Circuit rejected the equitable recoupment claim for failure to satisfy the "single transaction" requirement and because there was not an identity of interest between O'Brien and the estate (791 F.2d at 768). In fact, the Seventh Circuit specifically stated that it did not find the claim deficient on those grounds (766 F.2d at 1050 & n.16), and it took pains to emphasize that its holding was necessary to maintain "the rule against reopening closed tax years" (*id.* at 1051 n.17).

Court has noted in cautioning against undue expansion of the equitable recoupment remedy, "a statute of limitation is an almost indispensable element of fairness as well as of practical administration of an income tax policy" (*Rothensies* v. *Electric Storage Battery Co.*, 329 U.S. at 301). Moreover, the decision of the court of appeals effectively nullifies not only the limitations provisions of the Code, but also the detailed mitigation provisions enacted by Congress in 1938 because it makes equitable recoupment identical to mitigation—in that it allows an independent suit otherwise barred by the statute of limitations—but permits its invocation irrespective of whether the situation falls within the circumstances in which Congress determined that mitigation should be permitted.

The court of appeals' departure from fundamental jurisdictional principles is compounded by the clear conflict that it has created with decisions in other circuits. As matters now stand, similarly situated taxpayers will receive disparate treatment depending upon the circuit in which they reside. Taxpayers residing in the Sixth and Ninth Circuits will be able to claim a refund based on inconsistent treatment by the IRS of the same transaction, notwithstanding the fact that the claim is barred by the limitations provisions of Sections 6511 and 7422 of the Code, while taxpayers in the Seventh Circuit—and other circuits that follow the clear import of this Court's precedents—will be unable to maintain such a refund suit because of the statutory bar.

Moreover, the uncertainty that the decision below introduces into the law of equitable recoupment creates serious problems for taxpayers and practitioners in managing tax litigation. In *Commissioner* v. *Gooch Milling & Elevator Co.*, 320 U.S. 418 (1943), this Court held that the predecessor of the Tax Court, the Board of Tax Appeals, lacked jurisdiction to consider the taxpayer's equitable recoup-

ment claim, and it is generally believed that this restriction applies to the Tax Court today.[10] Thus, if a taxpayer desires to raise an equitable recoupment claim of the kind approved by this Court in *Bull,* he is well advised not to invoke the jurisdiction of the Tax Court to contest the deficiency (in the tax against which he proposes to offset or recoup the claimed overpayment), but rather to pay the deficiency and bring a timely refund suit in district court or the Claims Court. See Andrews, *supra,* 28 Ariz. L. Rev. at 614-615; Willis, *supra,* 38 Tax Law. at 641-642 & n.130; *O'Brien* v. *United States,* 766 F.2d at 1050 & n.15. The appropriateness of that tax advice, however, is cast into doubt by the decision in this case. Under the court of appeals' view of equitable recoupment, a taxpayer runs no risk by contesting the timely deficiency notice in the Tax Court; he can still raise his equitable recoupment claim by filing an untimely, independent refund suit in district court, as respondent did here.

Thus, the disarray in the circuits poses a dilemma for a taxpayer, or tax practitioner, in an uncommitted circuit who wishes to preserve his right to seek equitable recoupment, but would prefer to litigate in a prepayment forum. Conservative tax advice would counsel that he forgo his right to a prepayment forum in order to preserve his ability to raise equitable recoupment, even if the payment of the deficiency in order to be able to bring a refund suit

[10] The Tax Court is a legislative court of limited jurisdiction that is not invested with the inherent power of an Article III court. The Tax Court has held that it is subject to the rule of *Gooch Milling*. See *Estate of Van Winkle* v. *Commissioner,* 51 T.C. 994, 999-1000 (1969); *Estate of Garber* v. *Commissioner,* 17 T.C.M. (CCH) 646 (1958), aff'd on another issue, 271 F.2d 97 (3d Cir. 1959). See also *Rothensies* v. *Electric Storage Battery Co.,* 329 U.S. at 303; 4 B. Bittker, *Federal Taxation of Income, Estates and Gifts* ¶ 115.2.7, at 115-24 to 115-25 (1981).

poses a financial hardship. On the other hand, if the decision below is correct, incurring that financial hardship is unnecessary. It is thus important from the standpoint both of the government and of taxpayers and tax practitioners for this Court to resolve the uncertainty that has been engendered over the scope of equitable recoupment. Accordingly, this Court should grant certiorari and reaffirm that the equitable recoupment doctrine recognized in *Bull* does not authorize the maintenance of an action that is barred by the statute of limitations.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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JUNE 1989

APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

No. 88-1079

FRANCES L. DALM, PLAINTIFF-APPELLANT

v.

UNITED STATES OF AMERICA, DEFENDANT-APPELLEE

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF MICHIGAN

Decided and Filed February 8, 1989

Before: NELSON and NORRIS, Circuit Judges; and LIVELY, Senior Circuit Judge.*

LIVELY, Senior Circuit Judge. The doctrine of equitable recoupment holds that when a single transaction or taxable event has been subjected to two taxes on inconsistent legal theories, a taxpayer who meets certain requirements may recover a refund that would be barred otherwise by limitations. *Rothensies v. Electric Storage Battery Co.*, 329 U.S. 296, 299-300 (1946). In the present case the district court granted the government's motions to dismiss the complaint

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* The Honorable Pierce Lively became a Senior Circuit Judge on January 1, 1989.

and for summary judgment upon concluding that the taxpayer was not entitled to a refund of gift taxes by way of recoupment after the statute of limitations for a refund action had expired.

I.

A.

The historic facts are not in dispute. The taxpayer, Frances Dalm, was appointed administratrix of the estate of Harold Schrier in May 1975. The appointment was made at the request of the sole beneficiary of the estate, Clarence Schrier, brother of the decedent. The estate paid the taxpayer $30,000 in 1976 and $7,000 in 1977 as fees. These payments were approved by the probate court. In addition, Clarence Schrier transferred $180,000 to the taxpayer in 1976 and $133,813 in 1977. Clarence Schrier and his wife filed a gift tax return for 1976, showing the $180,000 payment as a gift to the taxpayer. The taxpayer paid the gift tax of $18,675 and interest and penalties of $1,587. No gift tax return was filed with respect to the 1977 transfer of $133,813.

The IRS audited the taxpayer's 1976 and 1977 income tax returns and mailed a notice of deficiency to her and her husband on June 21, 1983. The IRS determined that the two payments from Clarence Schrier were additional administrator's fees and asserted deficiencies of $96,045 in income tax and penalty for 1976 and $74,171 in income tax and penalty for 1977. The taxpayer challenged the deficiency in the Tax Court. She maintained that the two transfers, aggregating $313,813 and representing one-third of the net estate of Harold Schrier, were a gift from Clarence Schrier. The taxpayer had been an employee of Harold Schrier for many years prior to his death. The Tax Court petition stated that Clarence Schrier made the

transfers in order to carry out his brother's intention that the taxpayer share in his estate.

B.

After two days of trial the parties settled the Tax Court case for exactly one-half of the claimed deficiency without penalties. The stipulated decision, entered December 4, 1984, stated that there were deficiences in income taxes due from the taxpayer in the amount of $10,416 for the taxable year 1976 and $70,639 for 1977. The taxpayer paid these deficiences with interest and filed a claim for refund for $20,262, the amount of gift tax and penalty paid in December 1976 and March 1977. When the IRS failed to respond to the claim for refund within six months, the taxpayer filed the present action in district court on September 23, 1985.

In her complaint the taxpayer alleged that the Tax Court decision "determined that a portion of the money said gift tax was paid upon was taxable as income" and that it was inequitable for the government "to collect taxes on the same fund on the mutually exclusive theories of said amount of money being both income and a gift." She sought judgment for "overpaid gift taxes" in the amount of $20,262 with interest. After the government answered, the taxpayer filed a motion for summary judgment. The government then filed a cross-motion in the alternative to dismiss the complaint pursuant to Fed. R. Civ. P. 12(b)(6), or for summary judgment, relying specifically upon the three-year statute of limitations for filing claims for refund contained in Section 6511(a) of the Internal Revenue Code, 26 U.S.C. § 6511(a).

C.

In granting the government's motions, the district court determined that the doctrine of recoupment does not per-

mit a taxpayer to obtain a refund in an independent action after the statute of limitations for claiming a refund has expired. The court held that recoupment is "in the nature of a defense" that must be asserted in some action that has been timely commenced. As an alternative ground for dismissal, the district court found that the allocation of the settlement of the deficiency claim in the Tax Court could lead only to one conclusion—that the previously paid gift tax was taken into account in agreeing on the amount of income tax due. The court concluded that allocation of a small portion of the total agreed deficiency to the year in which the larger amount was received (1976) "was reflective of the tax already paid on that transfer, albeit a gift tax."

II.

On appeal the taxpayer argues that the district court misconstrued the requirement that recoupment be in the nature of a defense and thus erroneously concluded that this was an untimely independent action. She contends that recoupment is not required to be claimed as an actual defense to an action against the taxpayer, but only must be presented in the nature of a defense to a tax illegally collected. She maintains that her action is not barred, because her claim for refund was filed within three years after the IRS claimed a deficiency on the basis of a theory that was inconsistent with her earlier payment of a gift tax on the 1976 transfer. Thus, she asserts, her claim for recoupment was "in the nature of a defense."

The taxpayer also argues that the district court erred in its alternative basis of dismissal. She states that the allocation of the settlement does not give rise to the single inference that the agreement parties took into account the gift tax previously paid on the 1976 transfer. She contends

it is an equally valid inference that the smaller amount was allocated to 1976 to "sweeten the pot" for the taxpayer by reducing the total interest due under the settlement. The taxpayer argues that on this state of the record summary judgment was improper.

The government responds that equitable recoupment is a doctrine of limited application, and that the taxpayer is not within its reach. The government argues that the taxpayer in this case is attempting to use equitable recoupment offensively, rather than defensively. The government maintains that there are only two possible scenarios for the defensive presentation of a claim for recoupment. First, the "doctrine" may only support an independent action for refund of taxes when that action is not barred by the statute of limitations. Second, recoupment may accrue as an offset to the government's timely asserted deficiency determination. The government also argues that the plaintiff failed to demonstrate that she was subjected to double taxation on inconsistent theories, a condition precedent to the application of equitable recoupment. The proceedings in the Tax Court concerned income tax deficiencies for both 1976 and 1977. The taxpayer had paid a gift tax on the 1976 transfer only. It is clear, the government contends, that the allocation of the settlement satisfied the full income tax claimed for 1977, and took into account the previous payment of a gift tax for 1976.

III.

There is no statutory basis for permitting the recovery of a tax overpayment after the statute of limitations has expired. However, the Supreme Court has permitted such recoveries in limited circumstances under the doctrine of equitable recoupment. The first such case was *Bull v. United States*, 295 U.S. 247 (1935). The taxpayer contends

that *Bull* controls the present case and requires judgment in her favor. The government, on the other hand, relies on *Rothensies v. Electric Storage Battery Co.*, 329 U.S. 296 (1946), which narrowed the application of equitable recoupment in tax cases. See *Wood v. United States*, 213 F.2d 660, 661 (2d Cir. 1954) ("The gap in statutes of limitation created by the recoupment doctrine in tax cases seemed at one time to be fairly wide. But the gap has been narrowed markedly by McEachern v. Rose, 302 U.S. 56 . . . and Rothensies v. Electric Storage Battery Co., 329 U.S. 296").

A.

In *Bull* the Supreme Court permitted a decedent's estate to recover estate taxes paid in 1921 in a district court action filed in 1930, following rejection of a claim for refund filed in 1928. The decedent was a member of a partnership when he died in February 1920. The executor included the decedent's share of partnership profits from January 1, 1920, to the date of death as an asset of the estate in the estate tax return. The IRS determined in 1921 that the decedent's share of profits for the remainder of 1920 was also an estate asset, and the executor paid additional estate taxes on that amount. However, in 1925 the IRS concluded, during an audit, that the decedent's share of partnership profit for the February-December 1920 period was income to the estate. In July 1925 the IRS made a deficiency determination of income tax for 1920 with no deduction for the estate taxes previously paid on the value of the decedent's partnership interest.

The estate petitioned the Board of Tax Appeals (BTA) for a redetermination in September 1925. After the BTA upheld the deficiency determination, the estate paid the additional income tax and filed a claim for refund in July

1928. When the claim for refund was rejected, the executor filed suit in the Court of Claims in September 1930. In reversing the Court of Claims' denial of the estate's claim the Supreme Court held that the sums received by the estate as the decedent's share of partnership profits after his death were income to the estate, not part of the corpus of the estate. It was error to treat these sums as both assets of the estate and income to the estate under inconsistent theories. When the IRS determined that the profits for February-December 1920 were part of the corpus of the estate in 1921, the executor "had no reason to assume the Commissioner would adjudge the [same sums] income and taxable as such." *Id.* at 258. When the IRS made this latter determination in July 1925 the executor promptly protested that the same item "could not be both corpus and income of the estate." *Id.* It was not until the BTA ruled in the government's favor in April 1928 that the government had taxed the same transaction twice, providing the basis for a recoupment claim. It was then too late to file a claim for refund of the overpayment of estate tax. However, the estate paid the additional income tax and filed a claim for refund, insisting that the sums should have been treated as estate assets rather than income.

In explaining the application of equitable recoupment, the Supreme Court noted that "the usual procedure for the recovery of debts is reversed in the field of taxation." *Id.* at 260. An assessment has the force of a judgment and the burden of proof is shifted to the taxpayer even though the government is seeking to collect a debt and ordinarily would have the burden of proof. When the government began the new proceeding in July 1925 to collect income tax on the money previously taxed as part of the estate, the estate opposed full payment and demanded recoupment to the extent of the amount mistakenly collected as estate tax. Thus, although the estate had the burden of proof, since it

was asserted in response to a deficiency determination, the recoupment claim was "in the nature of a defense arising out of some feature of the transaction upon which the plaintiff's action [was] grounded." *Id.* at 262. By its action the government gave the estate a right to a credit or a refund. Although it could not assert this right in an independent action brought by it in 1930, the right had accrued and was available to the estate "since it was actionable and not barred in 1925 when the Government proceeded against [the estate] for the collection of income tax." *Id.* at 263. "Such a defense is never barred by the statute of limitations so long as the main action itself is timely." *Id.* at 262.

B.

The facts in *Rothensies* were quite different from those in *Bull* and the present case. The taxpayer, Electric Storage Battery Co., paid excise taxes on sales of batteries from 1919 to 1926. After it was determined that the sales were not subject to excise taxes, the taxpayer filed suit and obtained refunds in 1935 for taxes paid in 1922-1926, the years that were not barred by the statute of limitations. The government then asserted an income tax deficiency for 1935 upon determining that the refunds were income when received. The taxpayer paid the additional income tax and filed suit for a refund. After first denying that the refunded excise taxes were income, the taxpayer asserted that if they were income it should be able, as against the additional income tax, to recoup the amount of excise taxes paid between 1919 and 1922.

In reversing judgment for the taxpayer, the Supreme Court limited the application of equitable recoupment in tax cases as follows:

> It has never been thought to allow one transaction to be offset against another, but only to permit a transaction which is made the subject of suit by a plaintiff to be examined in all its aspects, and judgment to be rendered that does justice in view of the one transaction as a whole.

Rothensies, 329 U.S. at 299. The Court reviewed the facts in *Bull* and *Stone v. White*, 301 U.S. 532 (1937), and concluded that those two decisions exemplified the very limited application of recoupment in tax cases. It emphasized that in both instances a single transaction or taxable event had been subjected to two taxes on inconsistent legal theories. This was not the case in *Rothensies*. There the excise taxes were paid on one series of transactions, the sale of batteries. On the other hand, the income taxes were based, not on the sale of batteries, but on the receipt of refunds of the previously paid excise taxes. These refunds were taxable as income in 1935 because the taxpayer had obtained income tax benefits by deducting the excise taxes from its gross income in the years of payment. In *Rothensies* the government did not tax the same transaction under two inconsistent legal theories. It taxed two separate transactions undere separate legal theories that applied to those transactions. *Rothensies* was not a case where the court was required to examine *a transaction* "in all its aspects" and render judgment "that does justice in view of the one transaction as a whole." 329 U.S. at 299. Rather, the taxpayer sought to offset one transaction against another, a result that may not be obtained when refund on the basis of the earlier transaction is barred by the statute of limitations.

IV.

Three criteria must be satisfied for application of equitable recoupment in a tax case. There must be (1) a single transaction or taxable event, (2) that event must be

subjected to two taxes based on inconsistent legal theories, and (3) the amount claimed in recoupment must be barred by limitations while the government's deficiency claim must be timely. *Kolom v. United States*, 791 F.2d 762, 767 (9th Cir. 1986); *cf. Rothensies*, 329 U.S. at 300.

A.

We believe these criteria are satisfied in the present case. There was only one transaction—the payment of $180,000 to the taxpayer in 1976. The taxpayer paid a gift tax on this transaction in 1976 and the IRS did not question this treatment until 1983. When the IRS made its move the taxpayer challenged the deficiency based on the determination of the IRS that the transfer represented income rather than a gift. This issue was not settled until the stipulated decision treated the transfer as income and required the payment of $10,416 as additional income tax for 1976. Just as the executor in *Bull* has no final determination upon which to seek a refund of estate tax until the BTA ruled that the partnership profits were taxable as income of the estate, Mrs. Dalm had no final determination upon which to seek a refund of gift tax in the present case until the stipulated decision settled the question by determining that the 1976 transfer of $180,000 was taxable as income. Only at this point was the single transaction subjected to two taxes on inconsistent legal theories.

When Mrs. Dalm paid the additional 1976 income tax in 1984 she was in the same position as Bull's executor in 1928—she had paid two taxes on a single transaction or taxable event on mutually inconsistent legal theories. Although the taxpayer was the plaintiff in the refund action, her reliance on equitable recoupment was "in the nature of a defense." In addition, her refund action was not barred by the statute of limitations though filed more

than three years after the gift taxes were paid. Her claim for recoupment related to the government's timely deficiency action and was timely as well for purposes of recoupment.

B.

The district court concluded that the taxpayer was precluded from equitable recoupment because she sought it in "an independent lawsuit." The government seeks to support this holding by relying on *O'Brien v. United States*, 766 F.2d 1038 (7th Cir. 1985). After discussing the Supreme Court's holdings in *Bull, Stone* and *Rothensies*, the *O'Brien* court described the limited application of recoupment in tax cases:

> In view of the nature and underlying theory of equitable recoupment, it is clear that the doctrine cannot be used "as an independent ground for reopening years now closed by the statute of limitations." *Evans Trust v. United States*, 462 F.2d 521, 526, 199 Ct.Cl. 98 (1972), and requires the timeliness of the underlying action against which a party seeks to employ recoupment. As the Supreme Court explained in *Bull*, invocation of the doctrine "is never barred by the statute of limitations *so long as the main action itself is timely*." 295 U.S. 262, 55 S.Ct. at 700 (emphasis added).
>
> Attempts by taxpayers to utilize the doctrine to revive an untimely affirmative refund claims, as opposed to offset a timely government claim of deficiency with a barred claim of the taxpayer, have been uniformly rejected.

Id. at 1049.

A careful examination of *O'Brien* reveals that the government has misconstrued the court's reference to "an

independent ground" for reopening barred claims. The government reads this language to mean that a taxpayer may never rely on recoupment in a separate refund action brought after deficiency proceedings are concluded if such an action is barred by the statute of limitations. We construe the reference to "an independent ground" to mean that there must be a timely government claim of deficiency based on an inconsistent theory in order for a taxpayer to maintain an otherwise barred action for recoupment. The missing element in *O'Brien* was a timely claim for deficiency against which the claim for recoupment could be offset. The taxpayer had included a capital gain in his 1975 income tax return using as his cost basis the value of stock reported in his father's estate tax return in 1974. Sometime later the Tax Court entered a stipulated order setting the value per share of the inherited stock at a higher figure. The taxpayer then filed a claim for refund in ~~April~~ 1981, arguing that he had overpaid his income tax in the year of sale by using the lower value per share from the estate tax return in computing the capital gain. The government had never claimed a deficiency with respect to the taxpayer's 1975 income tax return, and it relied on the three-year statute of limitations as a bar to the refund action.

The district court granted a refund, but the court of appeals reversed. What made the taxpayer's action an attempt to use "an independent ground for reopening now closed tax years" was not the fact that limitations would otherwise have barred a refund action. Rather, it was the fact that the government had made no claim for additional taxes. O'Brien's action was truly an attempt to apply recoupment affirmatively in an independent action. The court stated:

> O'Brien untimely refund suit in 1983 asserts recoupment affirmatively to recover an erroneously paid tax

> and does not seek to offset the amount of a properly asserted and timely deficiency.[13]

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[13] A recoupment claim need not be made during an action by the government for payment of a deficiency. It is proper for the taxpayer to pay the entire amount of the properly owed tax and later make a timely refund claim with regard to this properly owed tax raising the defense of equitable recoupment in respect of another time-barred overpayment. See, *e.g.*, *Bull*, 295 U.S. 253, 262-263, 55 S.Ct. at 697, 700-701.

Id. Note 13 makes it clear that Mrs. Dalm's action was not "independent" because of the fact that she waited until the deficiency action in the Tax Court was completed before filing an otherwise barred refund suit.

C.

In other cases relied upon by the government recoupment was denied because one or more of the required elements was missing. In *United States v. Gulf Oil Corp.*, 485 F.2d 331 (3d Cir. 1973), recoupment was denied because two taxes had not been collected on one taxable event on the basis of inconsistent legal theories. Instead, there was a single erroneous collection of a tax, and the taxpayer lost its right to a refund by permitting the statute of limitations to run. The same defect prevented recovery by way of recoupment in *Brigham v. United States,* 470 F.2d 571 (Cl. Ct. 1972), *cert. denied,* 414 U.S. 831 (1973). After the taxpayers had paid taxes at ordinary income tax rates on stock transactions, a change in the law provided a basis for treating the stock sales as capital gains. They sought refunds for barred years on the theory of recoupment. However, two taxes had not been paid or collected.

There was simply an overpayment of taxes on a single transaction, and limitations had run. Recoupment does not permit a taxpayer who has paid only one tax to obtain a refund for barred years because a change in law or policy renders that payment erroneous. We have examined other Court of Claims cases cited by the government, and note that in each at least one element required for the application of recoupment was missing. See *Wilmington Trust Co. v. United States,* 610 F.2d 703 (Cl. Ct. 1979); *Evans Trust v. United States*, 462 F.2d 521 (Cl. Ct. 1972).

• • •

The district court erred in dismissing the taxpayer's recoupment claim on the ground that it was an independent lawsuit seeking a refund for a year for which the statute of limitations had run. *Rothensies* limited the application of recoupment in tax cases by making it clear that one transaction cannot be offset against another to circumvent the statute of limitations. However, *Rothensies* did not disturb the holding in *Bull* that when a single transaction is taxed twice under inconsistent legal theories and the government has collected the second tax in a timely action, the earlier tax can be offset against the later one in an action for refund. The present case, like *Kolom v. United States*, 791 F.2d 762 (9th Cir. 1983), satisfies the requirements for application of the doctrine of equitable recoupment.

V.

We believe it was error, also, to grant the government's motion for summary judgment on the alternative ground that the only plausible explanation for the allocation of the agreed income tax liability between 1976 and 1977 was that the allocation reflected the previously paid gift taxes on the 1976 transfer.

The stipulated decision decided only that there were deficiencies in income taxes for the taxable years 1976 and 1977, and allocated the agreed amount between the two years. The decision did not mention gift taxes. Attorneys who represented the taxpayer and the IRS in the Tax Court proceedings and in the district court filed declarations under oath. One attorney for the government stated that the taxpayer's attorney had proposed that any tax agreed to by the parties should be offset by the previously paid gift tax on the 1976 transfer, but that he had rejected this proposal. From this fact, the government lawyer argued in his memorandum that in settling "the plaintiff resolved all matters in issue with respect to her 1976 and 1977 income tax liability, including the right to recoup the amount of any gift tax that had been paid." In his opposing affidavit the taxpayer's attorney stated that "specific agreement was reached that the settlement would be without prejudice to Petitioner's right to subsequently file a claim for refund for gift taxes inconsistently paid and it was understood that such a claim would be filed immediately thereafter."

The record clearly demonstrates that the taxpayer paid two different taxes on the 1976 transfer of $180,000. What is not clear is whether the agreement to an income tax deficiency of only $10,416 with respect to that transaction included a credit for the $20,262 gift tax previously paid. If it did include such an offset, the two payments were not based on inconsistent legal theories. If this was the case, the earlier payment, though made as a gift tax, was credited against the taxpayer's total 1976 income tax liability in the final settlement and could be treated as an income tax payment. This is the construction the district court put on the settlement. On the other hand, if the total income tax deficiency agreed to by the parties reflected no allowance for the previously paid gift tax and represented

a complete settlement of income taxes for two years with consideration of the prior gift tax payments, then the same transaction has been taxed twice under inconsistent legal theories.

The taxpayer must be given an opportunity upon remand to demonstrate that the income tax settlement was reached without consideration of the previously paid gift tax and that she was, in fact, subjected to two inconsistent taxes on the 1976 transfer from Clarence Schrier. Unless she can establish this fact she will have failed to satisfy a basic requirement for application of equitable recoupment. The record discloses a sharp dispute over the meaning and effect of the agreed disposition of the Tax Court case. Under these circumstances, the government was not, at the motion stage, "entitled to a judgment as a matter of law." Fed. R. Civ. P. 56(c).

The judgment of the district court is reversed, and the case is remanded for further proceedings consistent with this opinion.

APPENDIX B

UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

File No. K85-419-CA4

FRANCES L. DALM, PLAINTIFF

v.

UNITED STATES OF AMERICA, DEFENDANT

[Filed Sept. 14, 1987]

OPINION OF THE COURT

HON. ROBERT HOLMES BELL

This is an action commenced by plaintiff, Francis L. Dalm, seeking refund of $20,262.19 in gift taxes, interest and penalties paid to the Internal Revenue Service with respect to a transfer to her of $180,000 in September 1976 by Clarence and Ethel Schrier. These tax amounts were paid by the Schiers in December 1976 and February 1977 and reimbursed by the plaintiff shortly thereafter. It appears further that in the year 1977, the Schriers transferred an additional $133,813 to the plaintiff but made no gift tax return nor paid any gift taxes on this 1977 transfer.

In 1983, the Internal Revenue Service mailed a notice of deficiency to plaintiff for the taxable years 1976 and 1977 asserting that the amounts of $180,000 and $133,813 were income and not gifts. In that same year, plaintiff and her

husband commenced a lawsuit in the United States Tax Court. The Tax Court proceeding resulted in a mid-trial settlement with a determination of income tax deficiencies for the years 1976 and 1977 of $81,055 allocated first to the entire deficiency determined for 1977 and the remaining amount to the taxable year 1976.

Plaintiff's claimed refund in this proceeding is predicated upon the conclusion that the Tax Court settlement determination of income tax deficiency for the transferred monies thereby extinguishes any gift tax consequence on the same monies and necessitates a refund of any gift tax previously paid.

Both parties' competing motions under FRCP 12(b) and 56 underscore that there are no outstanding factual issues requiring resolution.

Because this claim for refund was commenced well after the Internal Revenue Code Section 6511(A) statute of limitations had expired, the gravemen of this case becomes whether Equitable Recoupment may support this independent action for the refund of taxes otherwise barred by the statute of limitations.

The doctrine of Equitable Recoupment was first set forth in *Bull* v. *Uniited States* 295 US 247, (1935) and *Stone* v. *White*, 301 US 532 (1937). In *Minskoff* v. *United States* 490 F2d 1283 (2d Cir 1974) the Court stated at page 1285:

> The theory of the doctrine of equitable recoupment is that one taxable event should not be taxed twice, once on a correct theory and once on an incorrect theory [citations omitted] and that to avoid this happening the statute of limitations will be deemed waived. The doctrine does not allow a litigant to prove any and all mistakes made by him in reporting his tax. Most mistakes must be corrected within the time allowed by the statute of limitations. To succeed in avoiding the

> statutory bar the litigant must show that the opposing party seeks to treat the same item inconsistently as a matter of law.

However this doctrine is not without its limitations. In *Rothensies* v. *Electric Storage Battery Co.*, 329 US 296 (1947) at 299 the Supreme Court stated:

> It has never been thought to allow one transaction to be offset against another, but only to permit a transaction which is made the subject of suit by a plaintiff to be examined in all of its aspects, and judgment to be rendered that does justice in view of the one transaction as a whole.

The Court then concluded this discussion by stating:

> The application of this general principle to concrete cases in both the cited decisions (sic *Bull* and *Stone*) is instructive as to the limited scope given to recoupment in tax litigation.

While both counsel's briefs cite extensive reference to judicial discussion of Equitable Recoupment no precedent has yet been discovered in which an independent lawsuit, such as this suit, has been maintained for a refund for a year in which the statute of limitations has expired. Defendant's characterization of the doctrine as one in the nature of a defense appears accurate. See *O'Brien* v. *United States*, 766 F.2d 1038 (7th Cir. 1985).

Therefore, This Court must conclude that plaintiff cannot avail herself of the doctrine of Equitable Recoupment and must be bound by the running of the statute of limitations.

There is another reason why plaintiff cannot maintain this lawsuit. She contends that the Tax Court settlement was inclusive of the question of income tax liability and established the transactions of 1976 and 1977 were not gifts subject to gift tax liability.

Factually the liability which the plaintiff consented to as part of the Tax Court settlement was apportioned first to the taxable year 1977 in which no gift tax was reported or paid. In fact the majority of the liability was so applied and only $10,416 of the $81,055 was allocated to the taxable year 1976. This is interesting when the largest transfer occurred in 1976 not 1977. One cannot escape the conclusion that the smaller liability allocated for the year 1976 in light of the larger transfer in 1976 was reflective of the tax already paid on that transfer, albeit a gift tax. No other explanation appears plausible.

Finally, it appears that plaintiff is here seeking to relitigate the tax liability imposed upon the 1976 transfer at least partially by the Tax Court settlement. This cannot be permitted pursuant to section 6512(a) of the Internal Revenue Code. See *Elbert* v. *Johnson* 164 F.2d 421 (2d Cir. 1947).

Accordingly, the defendant's motions for DISMISSAL and SUMMARY JUDGMENT are hereby granted.

Dated: September 10, 1987

/s/ Robert Holmes Bell
ROBERT HOLMES BELL
United States District Judge

APPENDIX C

UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

No. 88-1079

FRANCES L. DALM, PLAINTIFF-APPELLANT

v.

UNITED STATES OF AMERICA, DEFENDANT-APPELLEE

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF MICHIGAN

[Entered Feb. 8, 1989]

JUDGMENT

Before: NELSON and NORRIS, Circuit Judges; and LIVELY, Senior Circuit Judge.*

THIS CAUSE came on to be heard on the record from the said district court and was argued by counsel

ON CONSIDERATION WHEREOF, it is now here ordered and adjudged by this court that the judgment of the said district court in this case be and the same is hereby reversed and the case is remanded for further proceedings consistent with this opinion.

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* The Honorable Pierce Lively became a Senior Circuit Judge effective January 1, 1989.

No costs taxed.

ENTERED BY ORDER OF THE COURT

LEONARD GREEN, Clerk

/s/ Leonard Green
Clerk

APPENDIX D

Section 6511 of the Internal Revenue Code (26 U.S.C.) provides in pertinent part:

Limitations on credit or refund

(a) Period of limitation on filing claim

Claim for credit or refund of an overpayment of any tax imposed by this title in respect of which tax the taxpayer is required to file a return shall be filed by the taxpayer within 3 years from the time the return was filed or 2 years from the time the tax was paid, whichever of such periods expires the later, or if no return was filed by the taxpayer, within 2 years from the time the tax was paid. Claim for credit or refund of an overpayment of any tax imposed by this title which is required to be paid by means of a stamp shall be filed by the taxpayer within 3 years from the time the tax was paid.

(b) Limitation on allowance of credits and refunds

(1) Filing of claim with prescribed period

No credit or refund shall be allowed or made after the expiration of the period of limitation prescribed in subsection (a) for the filing of a claim for credit or refund, unless a claim for credit or refund is filed by the taxpayer within such period.

(2) Limit on amount of credit or refund

(A) Limit where claim filed within 3-year period

If the claim was filed by the taxpayer during the 3-year period prescribed in subsection (a), the amount of the credit or refund shall not exceed the portion of the tax paid within the period, immediately preceding the filing of the claim, equal to 3 years plus the period of any extension of

time for filing the return. If the tax was required to be paid by means of a stamp, the amount of the credit or refund shall not exceed the portion of the tax paid within the 3 years immediately preceding the filing of the claim.

(B) Limit where claim not filed within 3-year period

If the claim was not filed within such 3-year period, the amount of the credit or refund shall not exceed the portion of the tax paid during the 2 years immediately preceding the filing of the claim.

(C) Limit if no claim filed

If no claim was filed, the credit or refund shall not exceed the amount which would be allowable under subparagraph (A) or (B), as the case may be, if claim was filed on the date the credit or refund is allowed.

Section 7422 of the Internal Revenue Code (26 U.S.C.) provides in pertinent part:

Civil actions for refund

(a) No suit prior to filing claim for refund

No suit or proceeding shall be maintained in any court for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected, until a claim for refund or credit has been duly filed with the Secretary, according to the provisions of law in that regard, and the regulations of the Secretary established in pursuance thereof.

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